401(k) Plan Sponsors Need To Focus On These Issues

By Ary Rosenbaum, Esq.

Too many plan sponsors ignore their retirement plans and by doing that, they are unknowingly putting themselves in harm's way. I know that plan sponsors are busy running their own businesses, but the nature of 401(k) plans requires their undivided attention. Plan sponsors need to get off their rear end and concentrate on certain key points in order to make sure that they have a plan in place that won't cost them in liability later down the line.

Why they should care? It will cost them if they don't.

A retirement plan is an employer-provided benefit. There are a lot of employer-provided benefits out there like health insurance, life insurance, gym membership, transit benefit, and even free milk and coffee. Unlike health insurance and free milk and coffee, employers have a lot of potential liability in running their retirement plan. That's because not only are they plan sponsors, but employers who sponsor a retirement plan also plan fiduciaries. The problem with being a plan fiduciary is the liability that goes with it because fiduciaries have the highest duty of care in law and equity. Plan sponsors have the highest duty of care because they're responsible for the retirement plan assets of their employees. If you lose your money, tough luck. If you lose money as a plan fiduciary, it's more than tough luck and you may be held personally liable even if you serve in a fiduciary capacity for the employer. Plan sponsors certainly need to get off their seat and understand that being a plan fiduciary means that they need to pay attention to their retirement plan.

Hiring good plan providers

One big aspect of my job is fixing errors of retirement plans either through voluntary compliance or after it's been conducted on plan audit. I also spent 9 years working for third-party administrators (TPAs) and 9 years working for law firms including 7 on my own. From my experience, the major difference for plans having lots of errors in administration and not is the quality of the providers they hire. While errors can be committed by the employer such as not depositing deferrals in a timely fashion, a good TPA will alert the plan sponsor of those errors. A TPA is probably the most important plan provider that a plan sponsor can hire. The reason why a TPA is more important than a financial advisor or even an ERISA attorney like me is because of the compliance and administration job that they're doing on the plan sponsor's behalf. Allocation, reporting, and compliance are just some of what a TPA does and these are where errors can pop up. It's nothing worse than for a plan sponsor to discover that the plan was top-heavy and the minimum contribution wasn't made for years or that the annual Form 5500 was never filed. While a TPA may be the most important plan provider, it's still essential to hire an experienced financial advisor for the plan who understands the fiduciary process of a retirement plan and is hired to properly manage it. Anyone can pick a good mutual fund lineup by looking at Morningstar or fi360, but not everyone knows how to properly education plan participants and memorialize the selection and replacement of investment options offered under the plan. A good financial advisor goes a long way in minimizing the plan sponsor's risk of holding retirement plan assets for plan participants whether they direct the investments or not. Why should plan sponsors care who they hire? Well thanks to being a plan fiduciary, the liability of any plan errors still will put the plan sponsor on the hook for liability. Whether the plan sponsors know or are responsible for the error or not, it's irrelevant. I've seen too many plan sponsors who protest their innocence when massive errors are detected and while I show some empathy, I tell them the truth: they're still responsible. The best way for plan sponsors to minimize the risk of errors in their plan is getting off their chair and hiring competent plan advisors.

Fees, fees, and fees

One of the most important duties that a plan sponsor has as a fiduciary is to make

sure the plan is paying reasonable plan expenses. Prior to fee disclosure regulations that were a major problem because many plan providers weren't transparent for the fees they were collecting directly and indirectly for the work they were doing. Since plan sponsors now get an annual fee disclosure, that problem no longer exists. However, the problem with fee disclosure is that too many plan sponsors don't bother to review the fees being charged against the plan and finding out whether it's reasonable for the services provided. Plan sponsors as employers can hire suppliers that charge more for the very same products offered by competitors. Plan sponsors just can't afford to do that when dealing with services performed for their plan. The way to determine the reasonableness of plan fees is to either benchmark them using a service or by seeking out pricing from competing providers. Again, it's all about reasonableness. So that means it's a mistake to hire a plan provider just because they're cheap. Plan sponsors have enough leeway to hire more expensive plan providers as long as it correlates to a higher level of service. I've seen too many plan sponsors learn the hard way by hiring a TPA just because they're cheap and then pay through the nose to correct big compliance errors.

Getting employees to defer and getting them educated

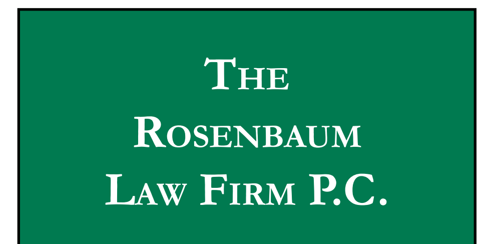
There are many reasons that a plan sponsor should make sure that their employees participate in the 401(k) plan and defer. Again, it's an employee benefit and the hope is that a 401(k) can be a vehicle that can be used to recruit and retain employees. The hope is also that employees can save for their retirement because the main component for savings under a 401(k) plan is the employee's salary deferrals. Another reason why it's important for rank and file employees to defer is because of compliance testing. If the highly compensated employees as a group defer more than 2% than what the non-highly compensated employees defer, then the plan will fail the deferral compliance test. A failed deferral compliance test (called the ADP test) needs to be corrected through refunds to highly compensated employees or a corrective contribution made by the plan sponsor. So there are many reasons why the plan sponsor needs to engage with participants and increase the salary deferrals in the plan. They can also help increase salary deferrals by placing an automatic enrollment feature for the employees who fail to affirmatively decline participation in the salary deferral component of the plan. Whether they decide to add automatic enrollment or not, it's important to hire plan providers who can properly communicate and engage plan participants with interactive tools that encourage participation. In addition, it's also important to make sure that participants get educated if they direct their own investments. The reason why they should make sure that plan participants get educated is that ERISA §404(c) which may protect a plan sponsor from liability for losses sustained by plan participants who direct their own investment requires that participants get enough information to make informed investment decisions. Bottom line, plan participants should be encouraged to defer and get educated if they direct their own investments under the plan.

Getting the proper insurance

All 401(k) plans with employee money require a fiduciary bond that protects plan assets from theft by plan participants. A plan sponsor should make sure the bond is in place and for the proper amounts, in relation to the size of plan assets. While a fiduciary (ERISA) bond protects plan assets, it does nothing to protect plan fiduciaries. So the plan sponsor should purchase fiduciary liability insurance to protect the fiduciaries of the plan they've put in place.

Keeping good records

Plan sponsors should keep all relevant plan records as well as all plan documents. There are just too many times where there are glaring plan errors and they can't be fixed because the plan sponsor doesn't have all the records. I've seen that too many times when the Internal Revenue Service claims the plan document is out of compliance just because the plan sponsor forgot to keep the signed copy of the plan document and/or plan amendment. A 401(k) plan sponsor needs to make sure all the records, fiduciary meeting minutes, and plan documents are in s a safe place.



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